

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:NER:UNY:TL-N-3379-99

ADMelzer

date: JUL 19 1999

to: Chief, Quality Measurement Staff, Upstate New York District  
Attn: Dawn DiCarlo

from: Assistant District Counsel, Buffalo

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subject: [REDACTED] - Interest Abatement Claims

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

The opinion that was issued on June 30, 1999 was sent to our National Office for review. In reviewing our opinion, the National Office recommended one modification to the [REDACTED] taxable year. Where the total overpayment reported on the return (a portion of this amount was later refunded and the remainder elected as credit) exceeded the subsequently determined deficiency, and the deficiency amount exceeded the amount of the credit elect, the taxpayer was entitled to only a portion of the amount refunded (\$[REDACTED]), and the deficiency interest would run

on the remaining amount of the refund, from the date of the refund, if refunded without interest, or from the unextended due date of the [REDACTED] return, if the refund was with interest. The amount of the deficiency reflected in the credit elect begins to accrue interest as of the date the credit elect is used to satisfy estimated taxes in the [REDACTED] year. The unused amount of credit elect is treated as a payment of income taxes for [REDACTED] and the Government would lose the use of this amount as an offset against the [REDACTED] deficiency as of the date the remaining credit elect amount is treated as a payment of [REDACTED] income taxes (the unextended due date of the [REDACTED] return).

Thus, the taxpayer received a \$[REDACTED] refund and elected to credit an additional \$[REDACTED] against its [REDACTED] estimated taxes. This totaled \$[REDACTED] as a "return overpayment." The Service subsequently determined a deficiency in the lesser amount of \$[REDACTED]. Therefore, as of the date of the refund, taxpayer was entitled to only \$[REDACTED] of the refund, and deficiency interest runs on the remaining amount of the refund as of the date of refund, if the amount was refunded without interest. With respect to the remaining deficiency amount (represented by the credit elect), you should follow the May Department Stores rules stated in our original memorandum.

You should also be aware of a typographical error on page 6 of our memo. In the second full paragraph, the last sentence should refer to the [REDACTED] tax return, not the [REDACTED] tax return. You should make the appropriate changes to our memorandum.

Please review the preceding changes to our original opinion and feel free to call Anne D. Melzer with any questions you might have. Mrs. Melzer can be reached at (716) 551-5614, ext. 30. Thank you for your cooperation in this matter.

EDWARD D. FICKESS

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Acting District Counsel

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Internal Revenue Service  
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**FACTS**

The taxpayer, [REDACTED], has requested May interest computations<sup>1</sup> for each of the taxable years [REDACTED] through [REDACTED]. All relevant statutes are open. Examination has already disallowed May interest computations for [REDACTED] and [REDACTED] because the taxpayer had no credit elects to apply to the subsequent

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<sup>1</sup> See May Department Stores Co v. United States, 96-2 USTC ¶ 50,576 (Ct.Cl. 1996). Under May, interest on a deficiency begins to accrue on the date an overpayment is credited to another year's tax liability.

years' installments. The relevant tax information is summarized on a year-by-year basis on the attached pages.

### ISSUE

Determination of the applicable date for the beginning of interest accruals on a deficiency, where there has been an application of a prior overpayment to pay that deficiency determined for the overpayment year. UIL 6402.01-02

### ANALYSIS

In general, the government is entitled to interest on a deficiency in tax for the period that the tax was due and unpaid. I.R.C. § 6601(a); Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978). If a deficiency in tax is determined after the taxpayer elects to credit a return overpayment against its estimated tax liability for the next succeeding year, interest will begin to accrue on the amount of the deficiency equal to the amount of the return overpayment as of the effective date of the credit election. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476. Pub. L. No. 98-369, 98 Stat. 494. Revenue Ruling 77-475 provides:

[i]f an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election. 1977-2 C.B. at 476 (emphasis added).

Accordingly, interest on the deficiency in the prior year begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356. However, the deficiency only becomes both due and unpaid, and thus triggers the running of interest on that deficiency, when the overpayment balance, after the application to the succeeding tax year's estimated taxes, is less than the deficiency for the overpayment year.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service generally has credited a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding taxable year unless the taxpayer attaches a statement to its return designating otherwise. However, in May Department Stores, the Court of Federal Claims concluded that the assumption behind the default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be deemed credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer does not designate the particular installment of estimated tax against which to apply the return overpayment and the installments of estimated tax due prior to the filing of the prior year's return are fully paid without the application of the return overpayment. May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq., AOD CC-1997-008.

In light of the May Department Stores decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under I.R.C. § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated tax under I.R.C. § 6655 with respect to such year.

The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date the prior year's tax became unpaid for purposes of I.R.C. § 6601(a). Prior to such date the government has had the use of the funds with respect to the prior year's tax, and no interest is payable on the overpayment that is the subject of the taxpayer's election. See I.R.C. § 6402(b); Treasury Reg. § 301.6402-3(a)(5) and § 301.6611-1(h)(2)(vii). Interest should be charged from the date the prior year's tax is both due and unpaid. May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq., AOD CC-1997-008 (Aug. 4, 1997); Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978); Rev. Rul. 88-98, 1988-2 C.B. 356.

Where the overpayment is not needed to satisfy any installment of estimated tax in the succeeding year, the overpayment is treated as a payment of the succeeding year's income tax. Section 6513(d) provides that if any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such

amount shall be considered as a payment of income tax for the succeeding taxable year (whether or not claimed as a credit on the return of estimated tax for such succeeding taxable year) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises. Also, I.R.C. § 6513(a) which provides that a payment of income tax made before the date prescribed for payment of the tax is considered paid on such date. The date prescribed for payment of tax is the time fixed for filing the return (determined without regard to any extension of time for filing the return). I.R.C. § 6151. Further, it is on such date that the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under I.R.C. §§ 6611(a) and (d). Thus, in our opinion, the statute requires that an overpayment which the taxpayer elects to credit against estimated tax for the succeeding year must be treated as a payment against such year's tax liability with an effective date no later than the due date of the succeeding year's return.

The taxpayer's factual situation does not fit within the fact pattern of either May Department Stores or Sequa v. United States, 1998 U.S. Dept. LEXIS 8556 (S.D.N.Y. June 8, 1998) because a portion of the [REDACTED] overpayment was needed to satisfy the first and second installments of estimated taxes for [REDACTED] to avoid the addition to tax for failure to pay estimated tax under I.R.C. § 6655.

The Sequa case stands for the proposition that interest on the deficiency for the first year should not begin to run where there has been no application of the overpayment to pay estimated taxes of subsequent tax years in order to avoid the addition to tax for failure to pay estimated taxes under I.R.C. § 6655, or the overpayment has not been refunded. However, the Service disagrees in part with the Sequa decision concerning the starting date of deficiency interest when the overpayment is not utilized to pay the succeeding tax year's estimated taxes. It is the Service's position that in all cases, the overpayment is a payment of the succeeding year's income tax liability deemed paid no later than the due date (without regard to extensions) of the succeeding year's income tax return.

We note that the Service disagrees with the conclusions reached by the District Court in Sequa as to the issue of when interest on the deficiency begins to run where all of the installments of estimated tax for the tax year immediately following the overpayment tax year are fully paid. As noted herein, it is the Service's position that even if the overpayment credit is not needed for the estimated taxes for the subsequent tax year, the latest date on which interest will begin to accrue

on the subsequently determined deficiency for the first year will be the due date of the return, without extensions, for the second year. Under the "use of the money" theory, it is on this date that the deficiency for the overpayment year became both due and unpaid, and interest on the deficiency begins to accrue on that date.

In the instant case, the [REDACTED], [REDACTED], [REDACTED], and [REDACTED] tax years have similar fact patterns. In all four of each such years, the taxpayer's deficiency exceeded its total credit elect. Therefore, at the time the tax returns for such years were due, the total payments made on each return were less than the revised tax liability (the deficiency amount added to the liability on the original return). Hence, the difference between the deficiency and the credit elect for each year began to accrue interest as of the due date of each original return.

For the [REDACTED] taxable year, \$[REDACTED] of the deficiency began to accrue interest as of the due date of the [REDACTED] return. For [REDACTED], \$[REDACTED] of the deficiency began to accrue interest as of the due date of the [REDACTED] return. For [REDACTED], \$[REDACTED] of the deficiency began to accrue interest as of the due date of the [REDACTED] return. For the [REDACTED] return, \$[REDACTED] of the deficiency began to accrue interest as of the due date of the [REDACTED] return.

For these same years, the credit elect amount began to accrue interest as of the date the credits were applied to unpaid installment(s) for the next year's tax return. For the [REDACTED] tax year, \$[REDACTED] of the credit elect was applied to the installment due on [REDACTED]. That portion began to accrue interest as of such date. Another \$[REDACTED] was applied to the [REDACTED] installment and began to accrue interest as of that date. The remaining credit elect of \$[REDACTED] did not begin accruing interest until the due date of the [REDACTED] tax return.

For [REDACTED], \$[REDACTED] was applied to the first installment of the [REDACTED] tax return. That amount began to accrue interest on [REDACTED]. Another \$[REDACTED] was applied to the second installment and began to accrue interest on [REDACTED]. Another \$[REDACTED] was applied to the third installment and began to accrue interest on [REDACTED]. The remaining unused credit of \$[REDACTED] did not begin to accrue interest until the due date of the [REDACTED] tax return.

For [REDACTED], \$[REDACTED] was applied to the third installment of the [REDACTED] tax return. That amount began to accrue interest on [REDACTED]. The remaining unused credit of \$[REDACTED] did not begin to accrue interest until the due date of the [REDACTED] tax return.

For [REDACTED], \$[REDACTED] was applied to the second installment of the [REDACTED] tax return. That amount began to accrue interest on [REDACTED]. An additional \$[REDACTED] was applied to the third installment and began to accrue interest on [REDACTED]. The remaining \$[REDACTED] was credited to the fourth installment and would begin to accrue interest on [REDACTED].

The two remaining years are [REDACTED] and [REDACTED]. For the taxable year [REDACTED], the deficiency exceeded the credit elect, but not the total overpayment. The taxpayer was refunded \$[REDACTED] when it filed its [REDACTED] tax return. That amount plus the credit elect of \$[REDACTED] exceeds the deficiency of \$[REDACTED]. A portion of the refunded amount, \$[REDACTED], began to accrue interest on the due date of the [REDACTED] tax return. A small portion of the credit elect, \$[REDACTED], was applied to the second installment of the [REDACTED] taxes. This amount began to accrue interest as of [REDACTED]. The remaining \$[REDACTED] was applied to the third installment and began to accrue interest on [REDACTED].

The last year to analyze is [REDACTED]. In that year, the credit elect of \$[REDACTED] far exceeded the deficiency of \$[REDACTED]. Only \$[REDACTED] was applied to any of the [REDACTED] installments. That amount was applied to the third installment and began to accrue interest on [REDACTED]. The remaining unused credit of \$[REDACTED] began to accrue interest on the due date of the [REDACTED] tax return. <sup>7</sup>[REDACTED]

We have summarized the treatment of interest for each of the years [REDACTED] through [REDACTED] (except [REDACTED] and [REDACTED] to which the May case does not apply). Note that we have used the corrected amounts of credit elect as shown on the bottom of each summary sheet. Please feel free to call Anne D. Melzer with any questions you might have at (716) 551-5614, ext. 30.

~~EDWARD D. FICKES~~

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EDWARD D. FICKES  
Assistant District Counsel